

AR10



INTERNATIONAL HARVESTER CANADA

Annual Report 1978



Overview

International Harvester builds a wide range of power equipment that provides the world with essential tools to ease work burdens, raise living standards and increase leisure enjoyment.

The Canadian Company's roots started 75 years ago when the first farm machines rolled off the Hamilton Plant assembly line. It was the beginning of an era which would see IH Canada grow and diversify across the land.

Through innovation and quality workmanship, IH people have helped to revolutionize the nation's key industries — agriculture, transportation, construction, natural resources, leisure and recreation.

The Company's commitment to improving productivity through mechanical power has remained constant. Over the years, this commitment has earned International a reputation for leadership in the industries it serves.

Products manufactured today feature the latest technology in agricultural equipment, trucks, construction/industrial equipment, recreational vehicles and outdoor lawn and garden products. A progressive, contemporary attitude toward providing products and services has earned the Company worldwide respect and recognition.

Four manufacturing plants, a centralized marketing office, district sales and finance offices, machine and parts distribution centres and a Canadian corporate headquarters serve the interests of domestic, U.S. and overseas markets.

The organization also includes Pacific Truck and Trailer, a specialized truck manufacturer, and Solar Turbines International, an operating group engaged in supplying power turbines to Canadian markets.

Diversification has also led to increased employment. From the original 800 workers back in 1903, IH has grown to the point where it now provides jobs for over 6300 people.

Exciting times are ahead. Recent product introductions are designed to meet the challenges of the 80's, when customers will demand a great deal more working power from their capital investments.

International's research and development of new equipment is a never-ending process . . . one that will introduce changes, refinements and special features to our lines of existing products. As in the past, International Harvester plans to build its leadership position in Canadian industry.



Financial Highlights

(fully consolidated basis)
(Dollars in thousands)

| | 1978 | 1977 |
|---------------------------------------|-------------|-----------|
| Sales | \$1,009,411 | \$875,207 |
| Net Income | \$ 35,412 | \$ 24,761 |
| Return on Sales | 3.51% | 2.83% |
| Return on Shareholders' Equity* | 21.62% | 16.87% |
| Dividends Paid | \$ 7,700 | \$ 8,000 |
| Income Retained for the Year | \$ 27,712 | \$ 16,761 |
| Taxes — Federal, Provincial and Local | \$ 38,376 | \$ 36,861 |
| Depreciation and Amortization | \$ 6,950 | \$ 6,254 |
| Capital Expenditures | \$ 10,234 | \$ 12,221 |
| Long-term Debt | \$ 153,978 | \$154,191 |
| Shareholders' Equity at End of Year | \$ 191,481 | \$163,769 |
| Average Number of Employees (Canada) | 6,347 | 6,867 |

*at beginning of the year

Directors and Officers

at October 31, 1978

Board of Directors:

Thomas L. Dougherty
Earle L. Edmonds
William R. Fleming
Edward R. Griffith
J. Patrick Kaine
Herbert V. Rose
Cedric C. Slain

Officers:

William R. Fleming
President
Herbert V. Rose
*Vice President,
Finance & Administration*
Edward R. Griffith
Secretary-Treasurer
William R. Ofield
Comptroller

Other Executives:

Robert L. Gregson
Director, Communications & Public Affairs
Ronald E. Penfold
Director, Technical & Support Services
John E. Reble
Director, Human Resources
John E. Colby
Manager, Truck Marketing
A. Keith Hibbard
Manager, Service Parts
Charles J. Munro
Manager, Agricultural Marketing
Donald A. Thorsell
Manager, Finance Sales



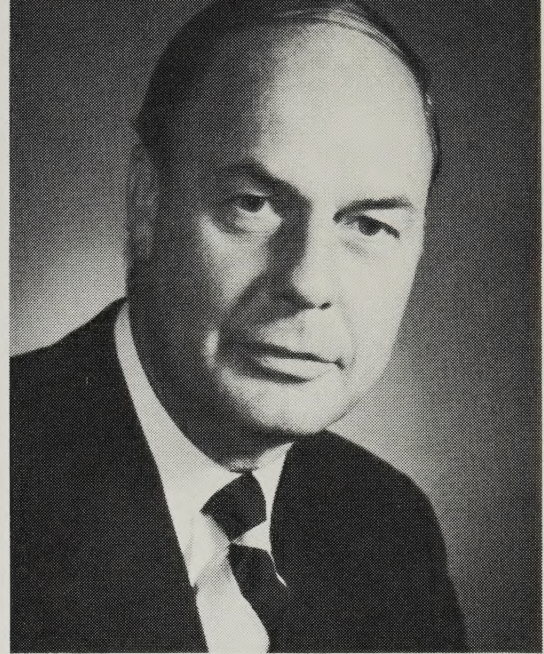
**INTERNATIONAL HARVESTER
CANADA**

General Offices: 208 Hillyard Street, Hamilton, Ontario, L8N 3S5

Annual Report 1978

The fiscal year ended October 31, 1978

Ce rapport est publié en français et en anglais.
Si vous préférez un exemplaire français, veuillez
écrire au Directeur des Relations publiques de
la Compagnie.



President's Message

I am pleased to report that 1978 saw record sales of \$1,009,411,000 and earnings of \$35,412,000.

These gains, in large part, were the result of new product introductions, a major restructuring of our marketing organization, new cost-efficiency measures and an improvement in our export performance.

All product lines contributed to the year's success.

Trucks

Trucks continue to play a major role in our economy, hauling over half of Canada's total tonnage, and are a basic part of every industry and community.

As Canada's economy has been increasingly dependent on trucks, their number has steadily grown, with the result that 1978 was another good year for International.

High acceptance of new S-Series trucks accounted for a significant level of marketing activity — and in this important heavy-duty market, International increased its leadership to better than 25% share of sales.

Last November, companions to the line, S-Series medium and medium-heavies, were introduced at our Chatham plant. Already, they are receiving high acclaim as a replacement to our famous Loadstar.

An interesting development in this market is the demand for diesel engines. Choice of heavy-duty operators for a number of years, diesel power is becoming more and more popular on medium-duty trucks — and with our DT-466 engine, IH sets the industry standard.

The achievements of our wholly-owned Vancouver-based subsidiary, Pacific Truck and Trailer, resulted in considerable growth.

Markets for Pacific's custom-built, on/off highway units have grown in four specialized vocations — woodlands, petroleum, mining and construction.

Supplying specially engineered and manufactured trucks for these markets around the world has resulted in an impressive performance picture for 1978.

Because of this, an extensive expansion of plant facilities is now being completed to accommodate stepped-up production at Pacific Truck and Trailer.

One of the fastest-growing markets is the 4-wheel drive fun vehicles.

By way of background, the industry sold 2000 units in 1970. Sales of 36,000 units are expected by the end of 1979, the result of an ever-increasing demand for dual-purpose vehicles that combine city driving convenience with freedom to leave the road behind.

Moving into 1979, we are encouraged by the prospects for further improvement of our truck business, when we consider the very heavy increase which we are experiencing in our order banks.

Agricultural Equipment

Agriculture is still one of the most dynamic and fast-changing industries as the farmer continues to write the book on productivity.

This is reflected by the fact that, in Canada, over 350,000 out of 10-million working Canadians grow enough for our own needs as well as for export.

This productivity has meant a lot to agriculture . . . and to every Canadian.

As a result of a bumper wheat crop, along with higher prices for other grains and beef, 1978 sales volume of agricultural equipment held up extremely well.

In serving the farm market, we are in an excellent position with the most advanced products for soil-conditioning, crop production, harvesting and materials handling.

Of course, the tractor plays a most important role in productivity — and at IH, meeting the trend to larger, more powerful tractors, we offer a full range up to 350 horsepower.

As pacesetters in tractor design and engineering, we recently introduced our new and revolutionary 2 + 2 mid-range articulated tractors that combine 2-wheel drive mobility with 4-wheel drive traction.

Complementing our tractors is quality-built equipment which further increases productivity — 65-foot cultivators, grain drills in multiples of four that span 56 feet, high capacity forage harvesters and balers that make 1500-pound bales.

One of our most innovative engineering concepts is the Axial-Flow Combine. Because of its cylindrical harvesting design, it has the ability to harvest more, in less time, with less grain loss.

This combine, introduced a little over a year ago, has received extremely high acceptance by Canadian farmers.

With farm cash income expected to increase from \$11.5 billion to \$12-billion in 1979, we expect to achieve greater IH penetration in this important market.

Payline Equipment

For the past few years, the construction and resource industries have lacked any real progress.

Although slow rate of growth in Canada's economy and commitment to restraint in government spending continue to affect sales of Payline products, we have seen an increase in our business during 1978.

Looking at 1979, we are hopeful, with continuing high production in the woodlands industry together with greater development of our mining resources and the possible start of a major pipeline, that demand for our crawler tractors, loaders, skidders and other woodlands equipment will continue to improve.

Exports again contributed strongly to our Company's success in 1978.

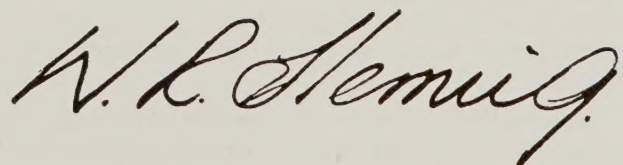
For 1979, we expect to further improve this performance based on the impact of the devalued Canadian currency matched with a more aggressive marketing approach in countries around the world.

Also, our goal to better control costs in the operation of our business has seen significant results — not only in marketing and manufacturing, but in all other disciplines of our Company.

We firmly believe these measures have resulted in greater efficiency, higher productivity and, most important of all, our ability to better serve our customers.

Summing up, although Canada is still faced with problems of slow growth, unemployment, inflation and balance of payments . . . our future looks bright and we approach 1979 with high expectations.

On behalf of the Board of Directors, I would like to thank our employees, customers and suppliers for their strong support. To all who made our achievements possible, we express our gratitude.



William R. Fleming

Agriculture

Farms are growing larger . . . and with Canada's short growing season, there's a need for more productive and efficient machinery. In this area, International sets the pace with continuing innovation to better meet every agricultural product vocation.

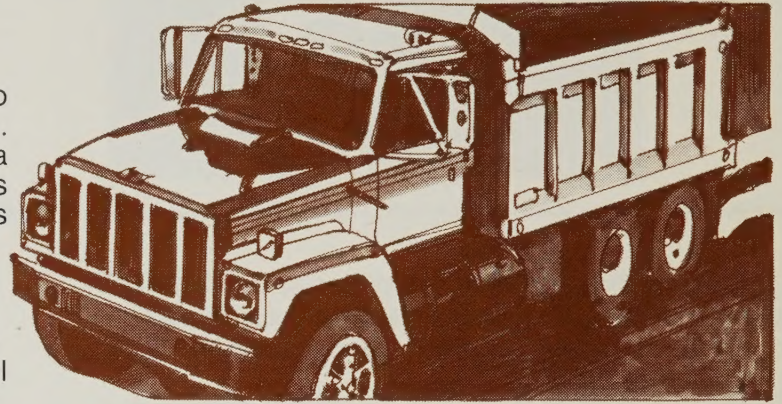
Canadian-built IH products include tillage, crop production and harvesting equipment, manufactured at Hamilton Plant, for both domestic and worldwide markets. Guided by a national marketing force, a network of dealers across the country sells and services our machinery to the nation's farmers.



Transportation

International trucks are designed and manufactured to serve the needs of the growing transportation industry. Cargostar and the new S-Series, produced in Canada at Chatham Plant, supply the vocational requirements of medium/medium heavy truck owners and operators across the country. In addition, these models are exported to U.S. and overseas markets.

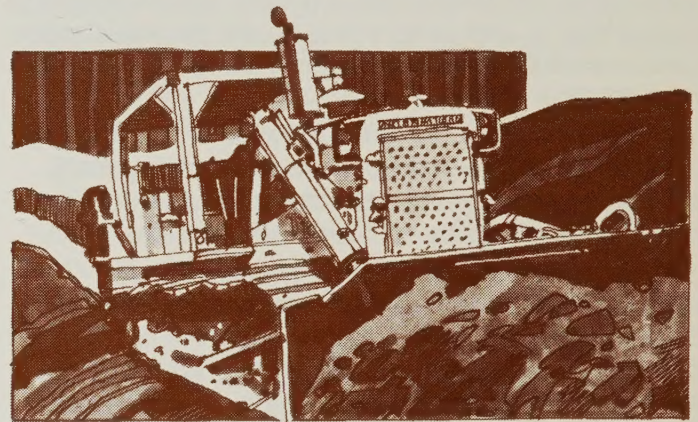
A leader in heavy duty trucks, IH manufactures vehicles designed for uses that range from highway hauling and construction to the development of natural resources. Through Pacific Truck & Trailer Ltd. in Vancouver, the Company builds a specialized line of truck which has numerous severe service applications both at home and abroad.



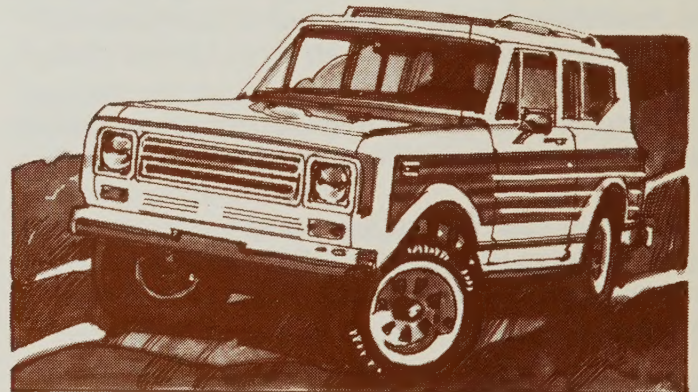
Construction, resource development and energy

Construction is a key industry in our economy. Equally important is the development of Canada's resources — mining, pulp and paper, lumber, oil and gas.

International Payline equipment is built to meet the needs of resource industries. Payline produces machines that work in conditions ranging from an open pit mine or forest to a construction site. International wheel loaders for domestic markets and log skidders for worldwide markets are built at Candiatic, Quebec.



The Company's Solar subsidiary, based in Alberta, distributes turbines for generating electrical power. Solar equipment in Canada is used at compressor stations for oil and natural gas transmission, at hospitals and essential utilities for supplying emergency power and at several Canadian industries as standby power systems.



Recreation

There is a consumer trend today toward recreational vehicles for both on and off-road use. Recognizing this significant market, International manufactures and distributes the Scout line of sport/utility vehicles.

Unlike conventional cars, the four-wheel drive feature gives Scout owners the ability to tackle off-road driving conditions — from dense wooded areas to rocky inclines. Yet, the vehicle is equally at home on the highway or in urban areas.

Lawn and garden

People who are concerned about their lawns and gardens choose equipment that gives professional results.

International Harvester manufactures such a range of power lawn and garden equipment including Cub Cadet tractors, garden tractors, riding mowers, roto tillers, walk-behind push mowers, washers and snowblowers.



Consolidated Statement of Income and Income Retained

For the Years ended October 31, 1978 and 1977

(Dollars in thousands)

| Sales and Other Revenues | 1978 | 1977 |
|---|-------------------|-------------------|
| Sales: | | |
| Canadian operations to — | | |
| Dealers and users in Canada | \$ 549,666 | \$ 474,260 |
| International Harvester Company | 279,917 | 266,991 |
| Other affiliated companies and jobbers | 11,062 | 8,435 |
| | <u>840,645</u> | <u>749,686</u> |
| Seddon Diesel Vehicles Limited | 168,766 | 125,521 |
| | <u>1,009,411</u> | <u>875,207</u> |
| Finance operations revenue | 28,026 | 28,024 |
| Total Sales and Other Revenues | <u>1,037,437</u> | <u>903,231</u> |
| Costs and Expenses | | |
| Cost of Sales | 875,306 | 755,052 |
| Marketing and administrative expenses | 65,099 | 62,045 |
| Interest expense | | |
| (including long-term of — 1978 \$16,251; 1977 \$15,274) | 34,308 | 30,788 |
| Sundry deductions less other income | 3,430 | 7,830 |
| Provision for income taxes: | | |
| Current | 18,831 | 19,723 |
| Deferred | 5,051 | 3,032 |
| Total Costs and Expenses | <u>1,002,025</u> | <u>878,470</u> |
| Net Income | 35,412 | 24,761 |
| Dividends Paid | <u>7,700</u> | <u>8,000</u> |
| Income Retained | | |
| — for the year | 27,712 | 16,761 |
| — at beginning of the year | 148,769 | 132,008 |
| — at end of the year | <u>\$ 176,481</u> | <u>\$ 148,769</u> |

*The accompanying Summary of Accounting Policies and Notes
are an integral part of this statement.*

Consolidated Statement of Financial Condition

October 31, 1978 and 1977

(Dollars in thousands)

| ASSETS | 1978 | 1977 |
|---|------------------|------------------|
| Current Assets | | |
| Cash | \$ 182 | \$ 315 |
| Notes receivable (note 1) | 217,260 | 206,473 |
| Accounts receivable — less allowances | 57,575 | 42,198 |
| Accounts receivable from affiliated companies | 1,859 | 829 |
| Inventories (note 2) | 180,622 | 146,645 |
| Other current assets | 4,622 | 3,634 |
| Total Current Assets | 462,120 | 400,094 |
| Notes Receivable, Long-term (note 1) | 181,257 | 146,427 |
| Property, Plant and Equipment | | |
| at cost, less depreciation & amortization (note 3) | 56,923 | 55,001 |
| Goodwill at cost less amortization | 3,924 | 4,211 |
| Other Assets | 9,947 | 6,698 |
| Total Assets | <u>\$714,171</u> | <u>\$612,431</u> |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current Liabilities | | |
| Bank indebtedness | \$ 23,589 | \$ 6,438 |
| Notes payable — banks | 19,514 | 23,917 |
| Notes payable — commercial paper | 178,086 | 156,273 |
| Current maturities of long-term debt (note 4) | 19,000 | 6,106 |
| Current invoices, payrolls and accruals | 91,038 | 75,667 |
| Accrued taxes | 4,653 | 6,603 |
| Accounts payable to affiliated companies | 14,906 | 6,592 |
| Deferred income taxes | 5,802 | 36 |
| Total Current Liabilities | 356,588 | 281,632 |
| Long-term Debt (note 4) | 153,978 | 154,191 |
| Deferred Income Taxes | 12,124 | 12,839 |
| Shareholders' Equity | | |
| Capital stock — authorized, issued and fully paid — 150,000 common shares of \$100 par value | 15,000 | 15,000 |
| Income Retained | 176,481 | 148,769 |
| Total Shareholders' Equity | 191,481 | 163,769 |
| Total Liabilities & Shareholders' Equity | <u>\$714,171</u> | <u>\$612,431</u> |

Approved by the Board: W. R. Fleming, *Director*
H. V. Rose, *Director*

The accompanying Summary of Accounting Policies and Notes are an integral part of this statement.

Consolidated Statement of Changes in Financial Position

For the Years ended October 31, 1978 and 1977

(Dollars in thousands)

| Source of Working Capital | 1978 | 1977 |
|--|--------------------|------------------|
| Net income | \$ 35,412 | \$ 24,761 |
| Items not affecting working capital: | | |
| Depreciation and amortization | 6,950 | 6,254 |
| Deferred income taxes | (715) | 1,594 |
| Amortization of goodwill | 287 | 233 |
| Working Capital Provided from Operations | 41,934 | 32,842 |
| Property disposals | 1,362 | 1,904 |
| Total Source | 43,296 | 34,746 |
| Application of Working Capital | | |
| Capital expenditures: | | |
| Canadian facilities | 9,215 | 11,413 |
| Equipment for lease | 297 | 107 |
| Seddon Diesel Vehicles Limited | 722 | 701 |
| Total Capital Expenditures | 10,234 | 12,221 |
| Dividends paid | 7,700 | 8,000 |
| Decrease (Increase) in long-term debt | 213 | (33,855) |
| Increase in notes receivable, long-term | 34,830 | 25,931 |
| Other — net | 3,249 | 1,978 |
| Total Application | 56,226 | 14,275 |
| (Decrease) Increase in Working Capital | (12,930) | 20,471 |
| Working Capital — at beginning of the year | 118,462 | 97,991 |
| — at end of the year | <u>\$105,532</u> | <u>\$118,462</u> |
| Changes in Working Capital | | |
| Current assets — (decrease) increase | | |
| Cash | \$ (133) | \$ 163 |
| Notes and accounts receivable | 27,194 | 41,637 |
| Inventories | 33,977 | 24,449 |
| Other current assets | 988 | (300) |
| Current liabilities — (increase) decrease | | |
| Bank indebtedness | (17,151) | 1,166 |
| Notes payable — banks and commercial paper | (17,410) | (27,336) |
| Current maturities of long-term debt | (12,894) | 10,948 |
| Current invoices, payrolls and accruals | (15,371) | (18,810) |
| Accrued taxes | 1,950 | (5,054) |
| Accounts payable to affiliated companies | (8,314) | (4,711) |
| Deferred income taxes | (5,766) | (1,681) |
| (Decrease) Increase in Working Capital | <u>\$ (12,930)</u> | <u>\$ 20,471</u> |

The accompanying Summary of Accounting Policies and Notes are an integral part of this statement.

Notes to Consolidated Financial Statements

| | (Dollars in thousands) | |
|--|------------------------|------------------|
| | 1978 | 1977 |
| 1. Notes Receivable | | |
| Notes receivable — wholesale | \$172,584 | \$152,680 |
| — retail | 265,135 | 238,939 |
| Unearned finance charges | (37,707) | (35,563) |
| Allowance for doubtful notes, deferred discounts and trade allowances | (1,495) | (3,156) |
| Total Notes Receivable | 398,517 | 352,900 |
| Less current portion | 217,260 | 206,473 |
| Notes Receivable, Long-term | <u>\$181,257</u> | <u>\$146,427</u> |
| 2. Inventories | | |
| Finished goods | \$ 91,155 | \$ 78,362 |
| Raw materials and supplies | 63,898 | 44,976 |
| Work-in-process | 25,569 | 23,307 |
| Total Inventories | <u>\$180,622</u> | <u>\$146,645</u> |
| 3. Property, Plant and Equipment | | |
| Buildings, machinery and equipment at cost: | | |
| Manufacturing | \$ 75,741 | \$ 70,234 |
| Distribution | 18,146 | 19,382 |
| Other | 8,569 | 9,159 |
| | 102,456 | 98,775 |
| Less accumulated depreciation | 55,454 | 54,304 |
| | 47,002 | 44,471 |
| Tooling and pattern equipment at cost, less amortization | 5,075 | 5,396 |
| Land at cost | 4,846 | 5,134 |
| Net Property | <u>\$ 56,923</u> | <u>\$ 55,001</u> |
| 4. Long-term Debt | | |
| International Harvester Company of Canada, Limited | | |
| Medium-term Notes, Series A, due 1978 to 1979 with interest at 10½% payable semi-annually | \$ 18,000 | \$ 20,000 |
| Subsidiaries | | |
| Senior indebtedness — Series A to D debentures and notes due 1978 to 1993 with interest at rates from 5¼% to a specified percentage over the Canadian bank prime rate for commercial loans, payable annually and semi-annually | 122,978 | 110,491 |
| Subordinated indebtedness — notes, due 1980 to 1991 with interest at rates from 6% to a specified percentage over the Canadian bank prime rate for commercial loans, payable semi-annually, quarterly and monthly | 32,000 | 29,800 |
| Other long-term obligations — 6% debenture due 1978 secured by subsidiary assets | — | 6 |
| | 172,978 | 160,297 |
| Less current portion | 19,000 | 6,106 |
| Long-term Debt | <u>\$153,978</u> | <u>\$154,191</u> |

The aggregate amount of payments required in each of the next five years to meet sinking fund and retirement provisions of the notes and debentures are: 1979, \$19,000,000; 1980, \$2,000,000; 1981, \$33,000,000; 1982, \$29,900,000; 1983, \$43,900,000. Covenants attached to the 10½% Medium-term Notes, Series A, restrict the distribution of earnings subsequent to November 1, 1973 to not more than 60% of consolidated net earnings available for distribution.

5. Retirement Plans

The Company has retirement plans in effect for eligible salaried and hourly rated employees. Total pension expense for 1978 was \$11,899,000 (1977 — \$8,787,000). Pension costs are computed on the basis of accepted actuarial methods and include amortization of past service costs. Past service pension costs of \$55,370,000 (1977 — \$58,680,000) which have not as yet been charged to operations will be amortized over the period to 1989. Approximately \$53,155,000 (1977 — \$35,366,000) of these past service costs relate to vested benefits.

6. Statutory Information

The remuneration to directors and senior officers as defined in the Business Corporations Act, Ontario, for the year ended October 31, 1978 amounted to \$318,000 (1977 — \$403,000).

7. Contingent Liabilities

The Company sold certain notes of its finance subsidiary, International Harvester Credit Corporation of Canada Limited, to banks with settlement of these notes guaranteed by the Company.

8. Anti-Inflation Legislation

Company profit margins, prices, compensation and dividends to October 31, 1978 were subject to the restraints imposed by the Anti-Inflation Act. Management is of the opinion that the Company has complied with the legislation.

Summary of Accounting Policies

Basis of Consolidation

The accompanying financial statements include the accounts of International Harvester Company of Canada, Limited and its wholly-owned subsidiaries, Pacific Truck and Trailer Manufacturing Ltd., Seddon Diesel Vehicles Limited, Harcan Leasing Limited and International Harvester Credit Corporation of Canada Limited on a fully consolidated basis.

The Consolidated Statement of Financial Condition contains the assets and liabilities of Seddon Diesel Vehicles Limited at October 31, 1978 and October 31, 1977. The operations of Seddon Diesel Vehicles Limited have been included in the Consolidated Statement of Income and Income Retained based on its results for the 12 month period ended October 31, 1978 and the 16 month period ended October 31, 1977 (see page 17 for details). Investments in co-dealerships are carried at cost. By way of supplementary information (pages 14 through 16) comparative financial statements for 1978 and 1977 are presented to reflect the results of Canadian manufacturing and trading operations on a basis which the Company considers to be more informative as this information is not available from the consolidated accounts. The Canadian manufacturing and trading subsidiary, Pacific Truck & Trailer Manufacturing Ltd., is consolidated. The investments in the foreign subsidiary, Seddon Diesel Vehicles Limited and the finance subsidiaries Harcan Leasing Limited and International Harvester Credit Corporation of Canada Limited are carried in the Statement of Financial Condition at the equity in their net assets and their earnings have been included in the Statement of Income and Income Retained.

Summarized financial data is set out separately for the major wholly-owned subsidiaries which have not been consolidated — Seddon Diesel Vehicles Limited and International Harvester Credit Corporation of Canada Limited — on page 17.

Foreign Exchange

With the exception of inventories, current assets and current liabilities in foreign currencies are translated into Canadian dollars at the year end exchange rates. Inventories have been translated at applicable historical rates. Other foreign currency assets and liabilities are translated at the exchange rates prevailing at the time of acquisition. Revenues, costs and expenses are translated at the average exchange rates for the year, except that depreciation expense is translated at the exchange rates prevailing at the time the related assets were acquired. Gains or losses resulting from exchange rate fluctuations are credited or charged to income currently.

Inventory Valuation

Inventories are valued generally at the lower of cost or market. Cost is determined substantially on the basis of average cost for the year including the cost of opening inventory. Market is considered as replacement value which does not exceed net realizable value for raw materials and supplies and work-in-process. For finished goods, market is considered as net realizable value less a normal profit margin.

Depreciation and Amortization

Depreciation and amortization are generally computed on a straight line basis over the useful lives of the various classes of properties.

Deferred Income Taxes

The Company and its subsidiaries recognize the tax effect of each item in the statement of income in the current period regardless of when the tax is paid. Taxes on amounts which affect financial and taxable income in different periods are reported as deferred income taxes.

Engineering and Research Expenditures

Expenditures for the development of new and improved products are charged to costs as incurred.

Auditors' Report

**Deloitte
Haskins+Sells**

Chartered Accountants,
6th Floor, EquiTrust Tower,
1 James Street South, Hamilton, Ontario L8P 4R5
(416) 523-6770 · Cable DEHANDS

To the Shareholders of International Harvester Company of Canada, Limited:

We have examined the consolidated financial statements of International Harvester Company of Canada, Limited as at October 31, 1978 and 1977 and for the years then ended. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests and other procedures as we considered necessary in the circumstances.

In our opinion, the accompanying consolidated financial statements (pages 7 through 11) present fairly the financial position of International Harvester Company of Canada, Limited as at October 31, 1978 and 1977 and the results of its operations and changes in its financial position for the years then ended in accordance with generally accepted accounting principles applied on a consistent basis.

Our examination also included the accompanying partially consolidated financial statements as at October 31, 1978 and 1977 and for the years then ended, which are presented as supplementary information to be read in conjunction with the above mentioned consolidated financial statements.

In our opinion, these partially consolidated financial statements (pages 14 through 16) present fairly the financial position of the Company as at October 31, 1978 and 1977 and the results of its operations and the changes in its financial position for the years then ended in accordance with generally accepted accounting principles, except that they are prepared on a partially consolidated basis, applied on a consistent basis.

Deloitte Haskins & Sells

December 1, 1978

Financial Review

Basis of Review

The financial review presentation is based on the financial data shown as Supplementary Information on pages 14 through 16. This sets out separately the results of Canadian manufacturing and trading operations and presents a more informative report in line with the Summary of Accounting Policies — Basis of Consolidation — on page 11. Separate data is displayed on page 17 for the major non-consolidated subsidiaries.

Sales

Sales of Canadian manufacturing and trading operations for 1978 reached an all time high at \$840,645,000 compared to \$749,686,000 in 1977. Domestic sales in 1978 were 15.9% higher than 1977. Agricultural Equipment sales increased marginally, while Truck, Outdoor Power Products, Payline, Solar and Components all increased significantly. Canadian produced goods sold to export markets in 1978 of \$290,979,000 showed an increase of 5.6% over 1977 and were the highest in the Company's history.

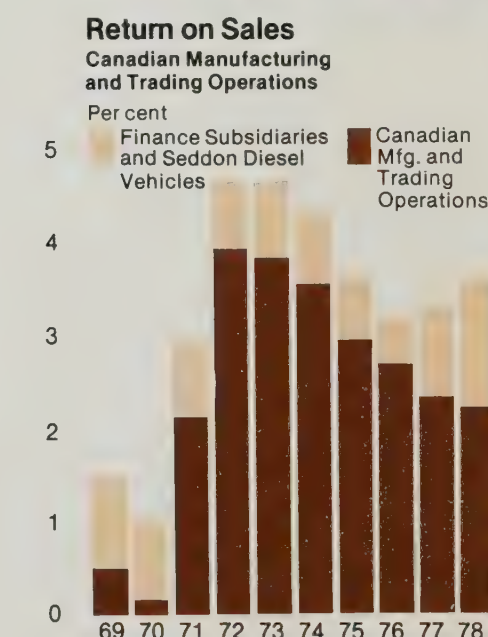
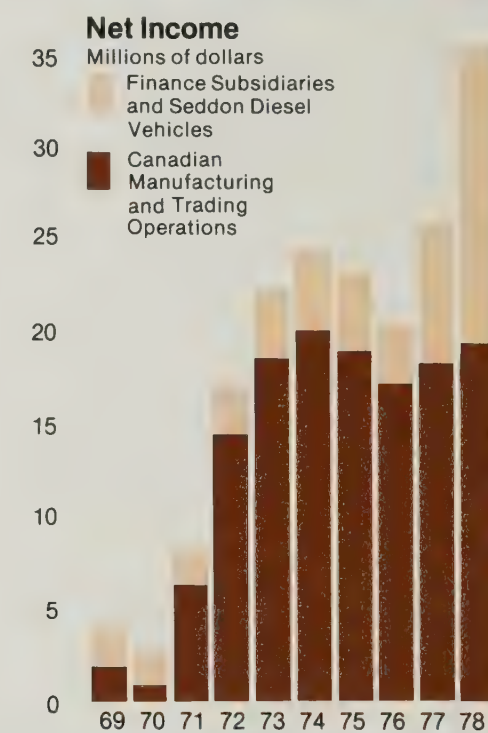
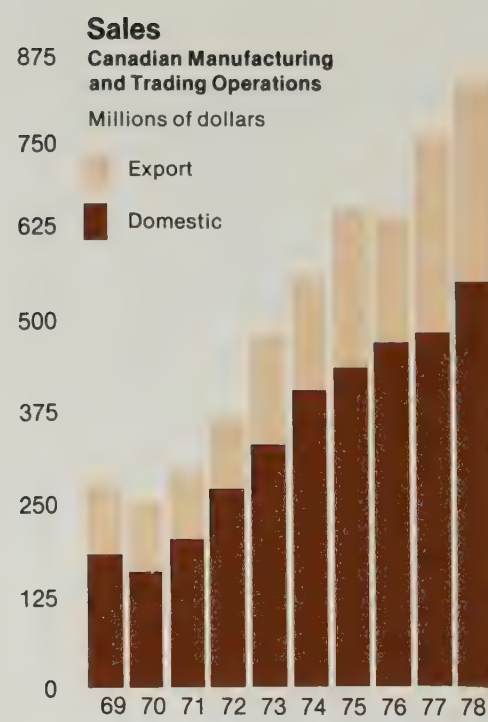
Net Income

Fully consolidated net income for 1978 was \$35,412,000 compared to \$24,761,000 for 1977, an increase of 43.0%. Income of the Canadian manufacturing and trading operations of \$19,354,000 increased 7.2% over 1977.

Return on sales decreased from 2.4% in 1977 to 2.3% in 1978 as increased revenues did not keep pace with increased costs and expenses. The restraints imposed under the anti-inflation program on prices and profits have continued to prevent the Company from maintaining margins. Compliance measurements under the regulations combined with depressed market conditions in some areas have restricted price increases to the degree that the Company has not been able to fully recover increased costs in some product lines.

Earnings of our major finance subsidiary, International Harvester Credit Corporation of Canada Limited of \$7,298,000 for 1978 increased 23.0% over 1977 and were an all time high. During 1978 a study indicated that provisions for losses on notes receivable were considerably higher than actual losses experienced. Using the results of this study, the allowance for losses at October 31, 1978 was established at \$1,495,000 (0.34% of total outstanding notes) compared to \$3,156,505 (0.80% of total outstanding notes) at October 31, 1977. This reduction in allowances resulted in a credit provision for losses in 1978 of \$1,279,000.

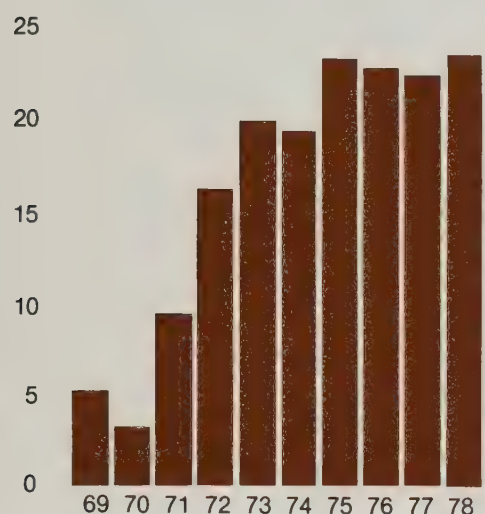
Net income, including consolidating adjustments, of Seddon Diesel Vehicles Limited for 1978 of \$8,647,000 was for a twelve month period ending October 31, 1978 compared to net income of \$632,000 for a sixteen month period ending October 31, 1977.



Working Capital (generated for the year)

Provided from
Canadian Manufacturing
and Trading Operations

Millions of dollars



Inventories

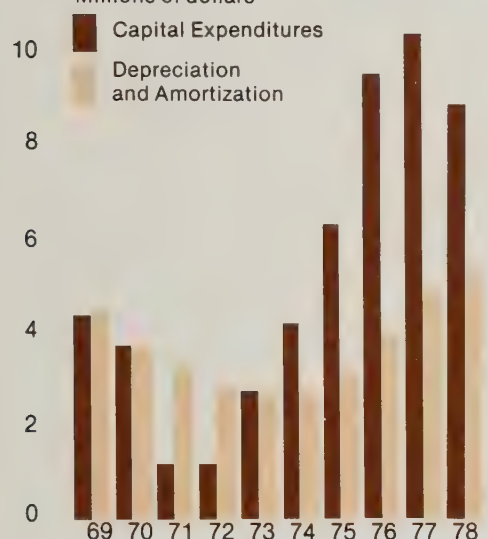
Canadian inventories of finished goods, raw materials and supplies and work-in-process were \$137,850,000 in 1978 compared to \$116,831,000 in 1977, an increase of 17.99%. Inventories are summarized by major classifications as follows:

| | 1978 | 1977 |
|----------------------------|------------------------|------------------|
| | (Dollars in thousands) | |
| Finished goods | \$ 76,433 | \$ 71,033 |
| Raw materials and supplies | 47,045 | 33,554 |
| Work-in-process | 14,372 | 12,244 |
| Total Inventories | <u>\$137,850</u> | <u>\$116,831</u> |

Capital Expenditures and Depreciation and Amortization

Canadian Manufacturing and
Trading Operations

Millions of dollars



Property, Plant and Equipment

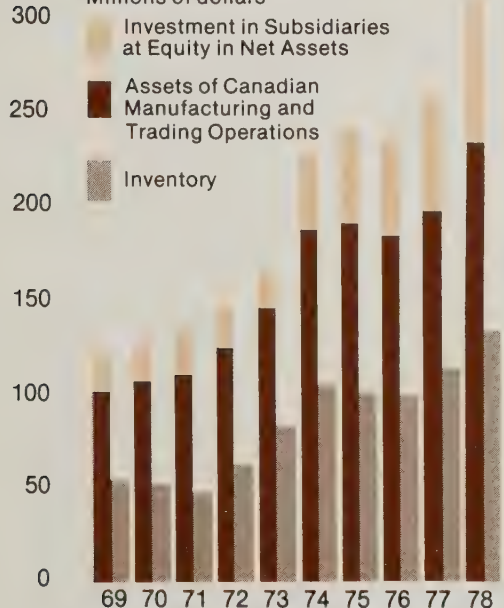
Capital expenditures of the Canadian manufacturing and trading companies totalled \$8,778,000 for 1978 fiscal year as compared to \$10,383,000 for the previous year. Commitments on appropriations in progress at October 31, 1978 approximated \$2,976,000. The continuing success of our Company dictates a commitment to increased productivity. The Company's investment plans continue to be dedicated to the modernization of facilities and subsequent improvement in overall productivity.

Property, plant and equipment by major classes are as follows:

| | 1978 | 1977 |
|--|------------------------|------------------|
| | (Dollars in thousands) | |
| Buildings, machinery and equipment at cost: | | |
| Manufacturing | \$ 68,919 | \$ 63,442 |
| Distribution | 17,037 | 17,949 |
| Other | 1,068 | 778 |
| | <u>87,024</u> | <u>82,169</u> |
| Less accumulated depreciation | <u>52,347</u> | <u>50,376</u> |
| | <u>34,677</u> | <u>31,793</u> |
| Tooling and pattern equipment at cost, less amortization | 4,308 | 4,322 |
| Land at cost | 1,613 | 1,712 |
| Net Property | <u>\$ 40,598</u> | <u>\$ 37,827</u> |

Inventory and Assets

Millions of dollars



Employment

The Company's average employment in Canada in 1978 was 6,347 compared to 6,867 in 1977. Compensation paid to employees in 1978 was \$99,839,000 of which \$87,186,000 was paid for time worked and \$12,653,000 was paid for vacations and statutory holidays. In addition, approximately \$24,901,000 was paid for insurance, medical and pension plans and other fringe benefits. Comparable 1977 compensation was \$107,475,000 of which \$94,995,000 was for time worked and \$12,480,000 was for vacations and statutory holidays. In addition, approximately \$21,406,000 was paid for fringe benefits in 1977.

Supplementary Information

This presentation sets out separately the results of Canadian manufacturing and trading operations by showing the financial position and results of International Harvester Company of Canada, Limited and Pacific Truck & Trailer Manufacturing Ltd., on a consolidated basis. The investments in the foreign subsidiary, Seddon Diesel Vehicles Limited, and in the finance subsidiaries, Harcan Leasing Limited and International Harvester Credit Corporation of Canada Limited, are carried in the Statement of Financial Condition at the equity in their net assets and their earnings have been included in the Statement of Income and Income Retained. Summarized financial data is set out separately for the major wholly-owned subsidiaries that have not been consolidated — Seddon Diesel Vehicles Limited and International Harvester Credit Corporation of Canada Limited — on page 17.



INTERNATIONAL HARVESTER COMPANY OF CANADA, LIMITED
(on a partially consolidated basis)

Statement of Income and Income Retained

For the Years ended October 31, 1978 and 1977

(Dollars in thousands)

| | 1978 | 1977 |
|--|------------------|------------------|
| Sales and Other Revenues | | |
| Sales: | | |
| Dealers and users in Canada | \$549,666 | \$474,260 |
| International Harvester Company | 279,917 | 266,991 |
| Other affiliated companies and jobbers | 11,062 | 8,435 |
| Total Sales | <u>840,645</u> | <u>749,686</u> |
| Costs and Expenses | | |
| Cost of Sales | 739,806 | 647,536 |
| Marketing and administrative expenses | 48,601 | 50,362 |
| Charges for financing services on wholesale notes sold to finance subsidiary | 18,741 | 13,470 |
| Interest expense | | |
| (including long-term of — 1978 \$2,039; 1977 \$2,339) | 3,763 | 4,533 |
| Sundry deductions less other income | 117 | 1,524 |
| Provision for income taxes: | | |
| Current | 13,453 | 15,342 |
| Deferred | (3,190) | (1,131) |
| Total Costs and Expenses | <u>821,291</u> | <u>731,636</u> |
| Income — Canadian Manufacturing and Trading Operations | 19,354 | 18,050 |
| Income — Canadian Finance Subsidiaries | <u>7,411</u> | <u>6,079</u> |
| Income — Total Canadian Operations | 26,765 | 24,129 |
| Income — Seddon Diesel Vehicles Limited | <u>8,647</u> | <u>632</u> |
| Net Income | 35,412 | 24,761 |
| Dividends Paid | <u>7,700</u> | <u>8,000</u> |
| Income Retained | | |
| — for the year | 27,712 | 16,761 |
| — at beginning of the year | 148,769 | 132,008 |
| — at end of the year | <u>\$176,481</u> | <u>\$148,769</u> |

The accompanying Summary of Accounting Policies, Notes 5 through 8 inclusive and the Financial Review are an integral part of this statement.

Statement of Financial Condition

October 31, 1978 and 1977

(Dollars in thousands)

| ASSETS | 1978 | 1977 |
|---|------------------|------------------|
| Current Assets | | |
| Cash | \$ 120 | \$ 102 |
| Accounts receivable — less allowances | 22,747 | 16,032 |
| Accounts receivable from affiliated companies | 1,436 | 198 |
| Notes and accounts receivable from finance subsidiaries | 15,923 | 14,923 |
| Deferred income taxes | 3,580 | 1,426 |
| Inventories (page 13) | 137,850 | 116,831 |
| Other current assets | 2,369 | 2,811 |
| Total Current Assets | 184,025 | 152,323 |
| Equity in Canadian Finance Subsidiaries | 54,289 | 42,607 |
| Equity in Seddon Diesel Vehicles Limited | 28,863 | 20,216 |
| Property, Plant and Equipment at cost, less depreciation and amortization (page 13) | 40,598 | 37,827 |
| Other Assets | 9,164 | 5,405 |
| Total Assets | <u>\$316,939</u> | <u>\$258,378</u> |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current Liabilities | | |
| Bank indebtedness | \$ 20,026 | \$ 6,173 |
| Notes payable — banks | 11,728 | 5,860 |
| Current maturities of long-term debt | 18,000 | 2,006 |
| Current invoices, payrolls and accruals | 56,883 | 48,661 |
| Accrued taxes | 3,463 | 4,643 |
| Accounts payable to affiliated companies | 13,882 | 6,490 |
| Total Current Liabilities | 123,982 | 73,833 |
| Long-term Debt | — | 18,000 |
| Deferred Income Taxes | 1,476 | 2,776 |
| Shareholders' Equity | | |
| Capital stock — authorized, issued and fully paid — 150,000 common shares of \$100 par value | 15,000 | 15,000 |
| Income retained | 176,481 | 148,769 |
| Total Shareholders' Equity | 191,481 | 163,769 |
| Total Liabilities and Shareholders' Equity | <u>\$316,939</u> | <u>\$258,378</u> |

Approved by the Board: W. R. Fleming, *Director*
H. V. Rose, *Director*

The accompanying Summary of Accounting Policies, Notes 5 through 8 inclusive and the Financial Review are an integral part of this statement.



Statement of Changes in Financial Position

For the Years ended October 31, 1978 and 1977

(Dollars in thousands)

| | 1978 | 1977 |
|---|--------------------|------------------|
| Source of Working Capital | | |
| Income — Canadian manufacturing and trading operations | \$ 19,354 | \$ 18,050 |
| Items not affecting working capital: | | |
| Depreciation and amortization | 5,340 | 4,762 |
| Deferred income taxes | (1,300) | (656) |
| Other | 111 | 111 |
| Working Capital Provided from Canadian Manufacturing and Trading Operations | 23,505 | 22,267 |
| Property disposals | 667 | 406 |
| Total Source | 24,172 | 22,673 |
| Application of Working Capital | | |
| Capital expenditures | 8,778 | 10,383 |
| Decrease in long-term debt | 18,000 | 2,006 |
| Dividends paid | 7,700 | 8,000 |
| Purchase of shares of International Harvester Credit Corporation of Canada Limited | 5,000 | — |
| Other — net | 3,141 | 789 |
| Total Application | 42,619 | 21,178 |
| (Decrease) Increase in Working Capital | (18,447) | 1,495 |
| Working Capital — at beginning of the year | 78,490 | 76,995 |
| — at end of the year | \$ 60,043 | \$ 78,490 |
| Changes in Working Capital | | |
| Current assets — increase (decrease) | | |
| Cash | \$ 18 | \$ (50) |
| Accounts receivable | 8,953 | (2,447) |
| Deferred income taxes | 2,154 | 475 |
| Inventories | 21,019 | 11,337 |
| Other current assets | (442) | (185) |
| Current liabilities — (increase) decrease | | |
| Bank indebtedness | (13,853) | 1,236 |
| Notes payable — banks | (5,868) | 3,640 |
| Current maturities of long-term debt | (15,994) | 2,030 |
| Current invoices, payrolls and accruals | (8,222) | (5,752) |
| Accrued taxes | 1,180 | (3,940) |
| Accounts payable to affiliated companies | (7,392) | (4,849) |
| (Decrease) Increase in Working Capital | \$ (18,447) | \$ 1,495 |

The accompanying Summary of Accounting Policies, Notes 5 through 8 inclusive and the Financial Review are an integral part of this statement.

Summarized Financial Data- Major Non-consolidated Subsidiaries

October 31, 1978 and 1977

(Dollars in thousands)

SEDDON DIESEL VEHICLES LIMITED

| | 1978 12 Months Ended October 31/78 | 1977 16 Months Ended October 31/77 |
|--|--|--|
| Net Sales | \$168,766 | \$125,521 |
| Net Effect on Consolidated Income | | |
| Seddon's net income (includes unrealized exchange loss on translation of \$3,140,000 in 1978 and \$1,523,000 in 1977) | \$ 8,498 | \$ 349 |
| Consolidation adjustments | 149 | 283 |
| Net Effect on Consolidated Income | \$ 8,647 | \$ 632 |
| Summary Statement of Financial Condition | | |
| Assets | | |
| Cash | \$ — | \$ 39 |
| Accounts and notes receivable — net | 17,603 | 10,983 |
| Inventories | 42,401 | 29,221 |
| Property, plant and equipment at cost, less depreciation | 9,467 | 10,057 |
| Other | 6,645 | 6,648 |
| Total Assets | \$ 76,116 | \$ 56,948 |
| Liabilities | | |
| Bank indebtedness | \$ 3,080 | \$ 7,992 |
| Notes, accounts payable and accruals | 31,362 | 25,320 |
| Long-term debt | 6,741 | 6,741 |
| Deferred income taxes | 12,885 | 3,332 |
| Total Liabilities | 54,068 | 43,385 |
| Shareholders' Equity | | |
| Capital stock | 3,997 | 3,997 |
| Income retained | 18,051 | 9,566 |
| Total Shareholders' Equity | 22,048 | 13,563 |
| Total Liabilities and Shareholders' Equity | \$ 76,116 | \$ 56,948 |

INTERNATIONAL HARVESTER CREDIT CORPORATION OF CANADA LIMITED

| | 1978 | 1977 |
|--|------------------|------------------|
| Net Income (before consolidation adjustments) | \$ 7,298 | \$ 5,933 |
| Summary Statement of Financial Condition | | |
| Assets | | |
| Notes receivable — net | \$415,008 | \$368,949 |
| Deferred income taxes | 729 | 1,445 |
| Prepaid interest and other assets | 3,439 | 4,296 |
| Total Assets | \$419,176 | \$374,690 |
| Liabilities | | |
| Notes payable within one year | \$175,039 | \$157,863 |
| Notes and accounts payable to parent company | 15,852 | 14,857 |
| Current maturities of long-term debt | 1,000 | 4,100 |
| Other current payables and accruals | 10,311 | 11,193 |
| Long-term debt | 153,978 | 136,191 |
| Deferred income taxes | 9,362 | 8,430 |
| Total Liabilities | 365,542 | 332,634 |
| Shareholders' Equity | | |
| Capital stock | 18,000 | 13,000 |
| Income retained | 35,634 | 29,056 |
| Total Shareholders' Equity | 53,634 | 42,056 |
| Total Liabilities and Shareholders' Equity | \$419,176 | \$374,690 |

Statistical Data

(fully consolidated basis) Dollars in millions

| | 1978 | 1977 | 1976 | 1975 | 1974 | 1973 | 1972 | 1971 | 1970 | 1969 |
|---|-----------|-------|-------|-------|-------|-------|-------|-------|-------|-------|
| SALES BY AREA OF FINAL SALE | | | | | | | | | | |
| Canadian Operations | | | | | | | | | | |
| Canada | \$ 549.7 | 474.3 | 460.3 | 425.2 | 399.4 | 338.3 | 266.7 | 202.2 | 159.2 | 185.3 |
| United States | 284.4 | 268.0 | 163.4 | 190.0 | 145.2 | 125.2 | 93.0 | 74.2 | 88.7 | 74.5 |
| Europe and Africa | 2.9 | 3.0 | 1.3 | 5.5 | 1.1 | 1.6 | 1.9 | .6 | .4 | .3 |
| Latin America | 1.2 | 1.1 | .9 | 1.6 | 1.3 | .7 | .9 | .3 | 1.0 | 1.1 |
| Pacific Area | 2.4 | 3.3 | 1.0 | 5.9 | 1.0 | 1.0 | 1.2 | 1.7 | .5 | .6 |
| | 840.6 | 749.7 | 626.9 | 628.2 | 548.0 | 466.8 | 363.7 | 279.0 | 249.8 | 261.8 |
| Seddon Diesel Vehicles Limited | 168.8 | 125.5 | 85.2 | 84.5 | — | — | — | — | — | — |
| Total | \$1,009.4 | 875.2 | 712.1 | 712.7 | 548.0 | 466.8 | 363.7 | 279.0 | 249.8 | 261.8 |
| NET INCOME | | | | | | | | | | |
| Amount | \$ 35.4 | 24.8 | 20.0 | 22.6 | 23.6 | 21.9 | 17.1 | 8.2 | 2.4 | 3.8 |
| Return on Sales | 3.51% | 2.83 | 2.81 | 3.17 | 4.31 | 4.69 | 4.70 | 2.94 | .96 | 1.45 |
| Return on shareholders' equity at beginning of year | 21.62% | 16.87 | 14.42 | 17.29 | 19.87 | 20.52 | 17.43 | 8.90 | 2.66 | 4.26 |
| DEPRECIATION AND AMORTIZATION | \$ 6.9 | 6.3 | 6.2 | 5.6 | 4.9 | 4.8 | 4.0 | 3.4 | 3.7 | 4.5 |
| TAXES — | | | | | | | | | | |
| FEDERAL, PROVINCIAL AND LOCAL | \$ 38.4 | 36.9 | 29.3 | 33.7 | 45.7 | 43.0 | 34.2 | 24.0 | 14.1 | 16.0 |
| CAPITAL EXPENDITURES | \$ 10.2 | 12.2 | 10.8 | 10.8 | 20.0 | 8.5 | 6.1 | 3.1 | 3.8 | 4.3 |
| SHAREHOLDERS' EQUITY | | | | | | | | | | |
| AT END OF YEAR | | | | | | | | | | |
| Capital stock | \$ 15.0 | 15.0 | 15.0 | 15.0 | 15.0 | 15.0 | 15.0 | 15.0 | 15.0 | 15.0 |
| Income retained | 176.5 | 148.8 | 132.0 | 123.7 | 115.7 | 103.8 | 91.7 | 83.1 | 77.1 | 75.2 |
| Total shareholders' equity | \$ 191.5 | 163.8 | 147.0 | 138.7 | 130.7 | 118.8 | 106.7 | 98.1 | 92.1 | 90.2 |
| REPRESENTED BY | | | | | | | | | | |
| Current assets | \$ 462.1 | 400.1 | 335.8 | 338.8 | 294.3 | 214.1 | 178.0 | 159.0 | 140.0 | 143.2 |
| Less: Current liabilities | 356.6 | 281.6 | 237.8 | 227.1 | 224.0 | 138.2 | 111.4 | 89.6 | 94.0 | 92.0 |
| Working capital | 105.5 | 118.5 | 98.0 | 111.7 | 70.3 | 75.9 | 66.6 | 69.4 | 46.0 | 51.2 |
| Net property | 56.9 | 55.0 | 50.9 | 50.2 | 45.9 | 31.6 | 28.3 | 27.0 | 29.0 | 29.5 |
| Notes receivable, long-term | 181.3 | 146.4 | 120.5 | 87.4 | 77.7 | 61.5 | 51.1 | 38.1 | 43.1 | 34.1 |
| Other assets | 13.9 | 10.9 | 9.2 | 9.9 | 9.8 | 4.4 | 4.3 | 4.5 | 4.1 | 1.7 |
| Total | 357.6 | 330.8 | 278.6 | 259.2 | 203.7 | 173.4 | 150.3 | 139.0 | 122.2 | 116.5 |
| Less: | | | | | | | | | | |
| Long-term debt | 154.0 | 154.2 | 120.3 | 114.0 | 71.7 | 54.6 | 43.5 | 40.4 | 29.5 | 26.0 |
| Deferred income taxes | 12.1 | 12.8 | 11.3 | 6.5 | 1.3 | — | .1 | .5 | .6 | .3 |
| Total | 166.1 | 167.0 | 131.6 | 120.5 | 73.0 | 54.6 | 43.6 | 40.9 | 30.1 | 26.3 |
| Total net assets | \$ 191.5 | 163.8 | 147.0 | 138.7 | 130.7 | 118.8 | 106.7 | 98.1 | 92.1 | 90.2 |
| NUMBER OF EMPLOYEES | | | | | | | | | | |
| AVERAGE (CANADA) | 6,347 | 6,867 | 6,556 | 7,120 | 7,144 | 6,510 | 5,667 | 4,812 | 5,828 | 6,189 |



INTERNATIONAL HARVESTER
CANADA